U.S. Senate Committee on Banking, Housing, and Urban Affairs

U.S. SENATOR RICHARD C. SHELBY, AL, RANKING MEMBER

EMBARGOED UNTIL BEGINNING OF HEARING

Contact: Jonathan Graffeo at (202) 224-0894
Jonathan_Graffeo@banking.senate.gov

STATEMENT OF SENATOR RICHARD C. SHELBY

The Role and Impact of Credit Rating Agencies on the Subprime Markets

9-26-07

"Thank you, Mr. Chairman."

"Until the highly-publicized failures to warn investors about the impending bankruptcies at Enron, WorldCom, and other large companies, credit rating agencies operated under the regulatory radar screen for decades, in spite of their important role in the capital markets. In recent months, widespread attention has been devoted to downgrades of credit ratings on structured financial products, particularly sub prime residential mortgage-backed securities."

"Numerous reasons have been offered for why the rating agencies got it wrong. Some have suggested the rating agencies awarded high ratings to curry favor with the large investment banks. Others have criticized the rating agencies for playing an active role in structuring these complex deals which presents a number of conflict of interest concerns. The purpose of this hearing is to explore these and other questions."

"In the 109th Congress, the Banking Committee conducted a comprehensive review of the market in which the rating agencies operate. This investigation revealed an extremely concentrated and anti-competitive industry. Two of the most profitable public companies in the U.S. operated what has been called a partner monopoly, each controlling approximately 40 percent of the industry's revenues and issuing 99 percent of corporate debt ratings. This virtual absence of competition was repeatedly cited as a major factor leading to ratings of inferior quality and practices deemed to be abusive and anti-competitive. The business model of debt issuers paying for their own ratings also led some to question whether the rating agencies could effectively manage the inherent conflicts of interest."

"The Committee's examination culminated in the passage of the Credit Rating Agency Reform Act of 2006. The Act is not yet a year old, so it is premature to judge its impact. Moreover, SEC regulations implementing the Act have only been in place for a few months."

(OVER)

“The centerpiece of the Act replaced the opaque SEC-staff licensing system with a more transparent and open registration system that will result in a greater number of ‘Nationally Recognized Statistical Rating Organizations’ or NRSROs. The Act also provided the SEC with broad authority to supervise the rating agencies. The Commission may examine registered rating agencies for compliance with the rules passed pursuant to the Act, such as the management of conflicts of interest, adherence to disclosed procedures and methodologies for determining ratings, and record keeping requirements. I look forward to hearing about the examinations currently underway, the first such exams conducted pursuant to the Act.”

“In light of recent difficulties, I also would like to know if the Commission has all the authority it needs to conduct vigorous oversight of the rating agencies. I understand that this is a very complex analytical discipline. The process of rating structured financial instruments can be confusing and difficult to comprehend. What is not difficult to comprehend, however, is the fact that some specific ratings were wrong and the subsequent downgrading actions by the rating agencies have had a serious impact on a significant sector of our financial system.”

“It is my hope that we will be able to use today’s hearing to explore what a rating is, what it is not, how it is determined and what leads an agency to change its rating. Finally, we will want to hear what went wrong. If there have been lessons learned, what are they, and what can be done to make sure it doesn’t happen again?”

“I would like to thank all of the participants for appearing here this morning and look forward to their testimony.”

“Thank you Mr. Chairman.”